Daiwa Capital Markets

Euro wrap-up

Overview

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- Bunds followed Treasuries lower as euro area retail sales returned to their pre-Covid level in June and the final July services PMIs signalled meaningful expansion.
- Gilts also made losses as the UK services PMI rose to a five-year high and car registrations bounced back.
- Tomorrow's BoE MPC announcement will see policy left unchanged, while the Bank's updated economic forecasts will be closely watched. German factory orders data and European construction PMIs are also due.

Daily bond market movements

Bond	Yield	Change
BKO 0 06/22	-0.707	+0.014
OBL 0 10/25	-0.702	+0.037
DBR 0 08/30	-0.508	+0.047
UKT 0½ 07/22	-0.054	+0.016
UKT 0⅝ 06/25	-0.100	+0.034
UKT 4¾ 12/30	0.128	+0.052

*Change from close as at 4:30pm BST.
Source: Bloomberg

Euro area

Retail sales return to pre-Covid level

While last week's flash estimate of Q2 GDP saw output in the euro area plunge by a record 12.1%Q/Q, retail sales figures for June today shed more light on consumption at the end of the second quarter. And with many countries having relaxed restrictions further, sales continued to be supported by pent-up demand, with a rise of 5.7%M/M following a record surge of 20.3%M/M in May. This saw sales return to their pre-lockdown peak and up a little more than 1%Y/Y. With the exception of Germany, the rebound was pronounced across the member states. For example, sales were up by double-digit monthly rates in Italy (13.8%M/M) and Spain (16.5%M/M), while sales in France were up almost 9½%M/M. Core spending was up by more than 12%M/M, underpinned by a surge in sales of textiles (20.4%M/M). But textile sales were still down around a fifth compared with February's peak. And despite a further jump in fuel sales in June, they too were still more than 12% below the pre-Covid level.

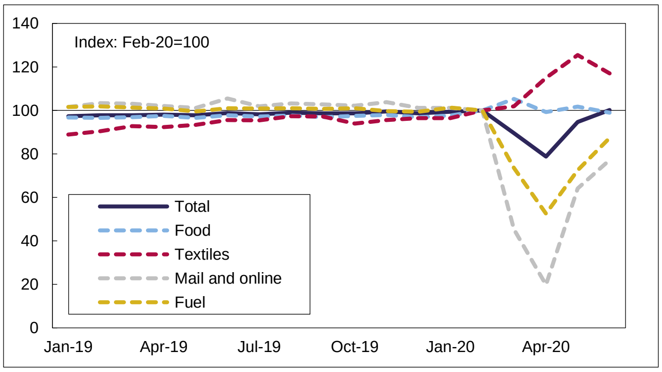
German auto sales recovery still weak

Of course, retail trade accounts for only around 40% of euro area consumption. The recovery in auto sales (around 5% of consumption), meanwhile, has been more mixed among member states. While July figures published earlier in the week showed that car registrations were up compared with a year ago in France and Spain, they continued to fall in Italy. And today's equivalent numbers from Germany showed that, despite the government's 3ppt VAT cut at the start of July, sales were still down 5.4%Y/Y last month, at 315k units – the lowest July reading for three years. So combined with the weakness seen earlier in the year, year-to-date sales were down more than 30%Y/Y, admittedly a slightly more favourable outturn than the other large member states.

Final services PMI revised down, but consistent with meaningful expansion

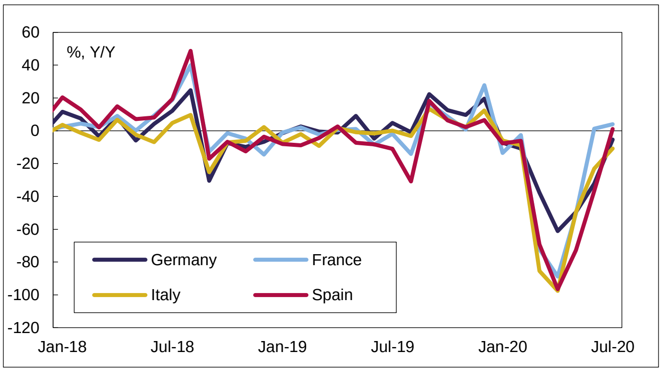
Given stricter containment measures in the services sector, the recovery in spending on such activities seems likely to lag far behind that for expenditure on goods. Certainly, today's final July services PMIs for Germany, France and the euro area were revised marginally lower from the flash estimates as concerns mounted about a second wave of Covid cases and localised lockdowns. Nevertheless, the final figures still signalled a notable improvement in activity at the start of Q3, consistent with a return to meaningful expansion for the first time since February. In particular, the headline euro area services index increased 6.4pts from June to 54.7, a twenty-two-month high. Like the manufacturing surveys, the services PMIs suggested that France leads the way among the member states, with the respective headline index up 6.6pts to 57.3. Germany's services PMI was also more convincing in July, up more than 8pts at 55.6. But although the equivalent index from Italy

Euro area: Retail sales



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Car registrations by member state



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

posted a notable rise on the month (+5.2pts), it was consistent with only modest expansion (51.6). The Spanish PMI was also more contained, rising just 1.7pts to 51.9, as weaker than expected new business – particularly from overseas – and reduced capacity restricted activity. And despite the recovery in activity, today's survey suggested that services firms across all member states continued to cut employment in July.

With the final manufacturing indices published earlier in the week having been revised higher from the flash release, there were only minimal changes to the final composite PMIs. In particular, the euro area index was nudged up to 54.9, 6.4pts higher than June, to leave it 41.3pts above April's low and the firmest reading for two years. The composite PMIs suggested a similar pecking order in terms of member states, with France leading the recovery (57.3), followed by Germany (55.3), Spain (52.8) and Italy (52.5). But while firms were more confident about the outlook over the coming twelve months, new orders were still relatively soft. And with margins being squeezed by rising operating costs associated with social distancing, job losses persisted across the region, with the steepest falls in employment reported in Italy, Spain, Germany and then France.

The day ahead in the euro area

Following today's services PMI, tomorrow brings the equivalent construction surveys from various member states, which are expected to signal recovery in July, albeit to a lesser extent than in the services and manufacturing sectors. Thursday will also bring German factory orders data, which are expected to post another strong rise in June, following May's 10.4%M/M increase. But this would still leave them down 18.5% on a year earlier. Meanwhile, Italian industrial production is also expected to have risen for the second successive month in June, albeit to a much smaller degree than the more-than 40%M/M surge in May, to leave output still significantly lower compared to a year earlier.

UK

PMIs point to rebound in July as economy reopens

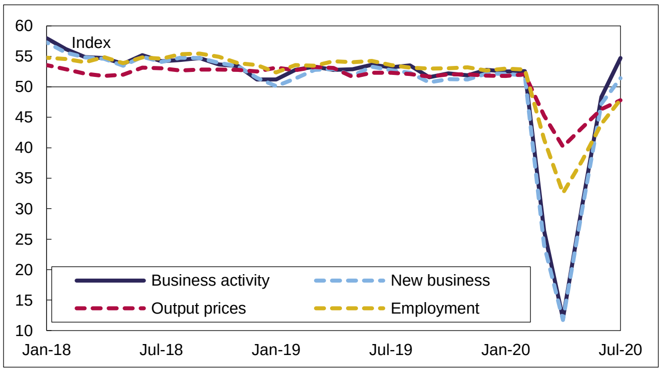
Like in the euro area, the final July services PMI was nudged slightly lower in the UK. But given the relaxation in containment measures and reopening of businesses last month, it still pointed to a marked improvement in activity. Indeed, at 56.5, the headline index was almost 9½pts higher than June, leaving it 43pts above April's trough and its strongest reading for five years. This notwithstanding, less than 40% of respondents suggested that output had risen in July, with still around a quarter reporting a decline. And while new business had improved – the relevant index was up 7½pts to 54.3 – firms also noted that projects had been cancelled and spending was subdued as economic uncertainties remained high. Indeed, with demand having been weaker than expected, services firms further cut employment last month, at a slightly steeper rate than in June.

Overall, there was another meaningful increase in the composite PMI, by 9.3pts on the month, to 57.0, a five-year high and implying strong growth last month. But with overseas demand still declining, the improvement in new orders, while notable, was more modest. So with firms reportedly having to absorb higher costs associated with strict social distancing rule, the survey suggested that job losses across the economy as a whole were still significant. And with the phasing out of the government's furlough scheme having begun at the start of August, diminished labour market prospects seem set to weigh on the recovery over coming months.

Car registrations bounce back

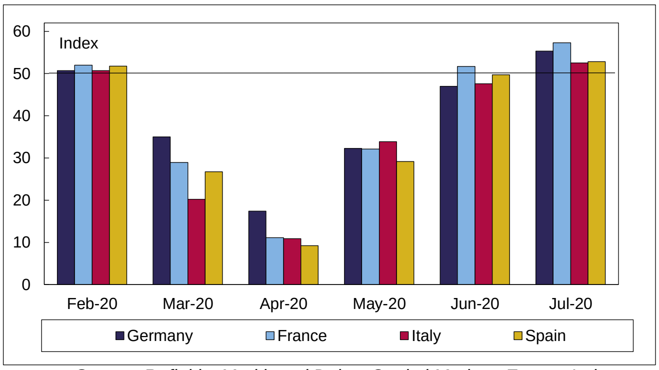
Car registrations were also given a boost in July as dealerships across the UK opened for their first full month of trading since February. In particular, sales saw their first year-on-year increase of 2020 in July, by 11.3%Y/Y, supported by pent-up demand and special offers. But given the significant weakness through the first half of the year, sales were still down in the first seven months of the year by a whopping 41.9%YTD/Y. And despite the recovery in July, the Society of Motor

Euro area: Services PMI components



Source: Refinitiv, Markit and Daiwa Capital Markets Europe Ltd.

Euro area: Composite PMIs by member state



Source: Refinitiv, Markit and Daiwa Capital Markets Europe Ltd.

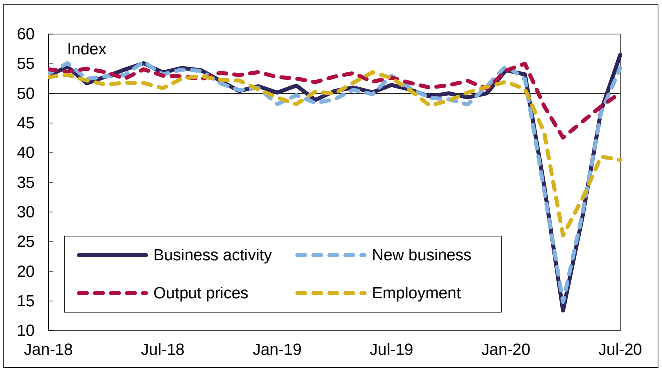
Manufacturers and Traders (SMMT) still anticipates significant losses over the year as whole, forecasting a full-year drop of 30%Y/Y in 2020 as subdued consumer confidence and a weakening labour market will no doubt weigh on demand over coming months.

The day ahead in the UK

The main event in the UK tomorrow will be the BoE's latest monetary policy announcement. Having expanded its asset purchases in June by a further £100bn, we expect the main policy parameters – Bank Rate at 0.1% and the asset purchase target of £745bn – to be left unchanged. Of more interest will be the Bank's updated economic forecasts in its latest Monetary Policy Report (MPR). At June's MPC meeting, Bank staff assessed that the recent contraction had been somewhat less severe than initially anticipated, estimating that the level of GDP in Q220 might be 20% below the peak reached in Q419, compared with the 27% projection under its illustrative scenario in the May MPR. And that would be broadly consistent with recent activity data. But with heightened concerns about the recent rise in coronavirus infections, delay in reopening certain industries and new localised lockdowns, the MPC might be slightly more downbeat about the prospects for the near-term recovery. With output set to remain well below the pre-pandemic level for several years to come, and the temporary VAT cut to the hospitality and entertainments sector set to add further downward pressure over the near term, we would expect the Bank to maintain its view that underlying price pressures will remain subdued for the foreseeable future.

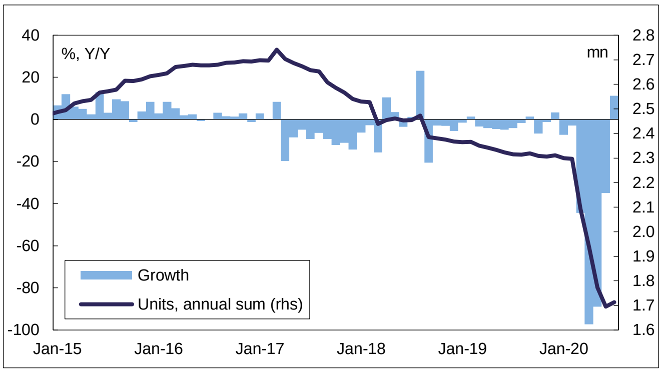
On the data front, tomorrow sees the release of the construction PMI for July, which is expected to signal that activity in the sector continues to recover. The REC/KPMG report on jobs for the same month will also be also published and likely to maintain a downbeat assessment.

UK: Services PMI components



Source: Refinitiv, Markit and Daiwa Capital Markets Europe Ltd.

UK: Car registrations



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

European calendar

Today's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
EMU	Final services (composite) PMI	Jul	**54.7 (54.9)**	55.1 (54.8)	48.3 (48.5)	-
	Retail sales M/M% (Y/Y%)	Jun	**5.7 (1.3)**	6.8 (0.4)	17.8 (-5.1)	20.3 (-3.1)
Germany	Final services (composite) PMI	Jul	**55.6 (55.3)**	56.7 (55.5)	47.3 (47.0)	-
	New car registrations Y/Y%	Jul	**-5.4**	-	-32.3	-
France	Final services (composite) PMI	Jul	**57.3 (57.3)**	57.8 (57.6)	50.7 (51.7)	-
Italy	Services (composite) PMI	Jul	**51.6 (52.5)**	52.6 (51.1)	46.4 (47.6)	-
Spain	Services (composite) PMI	Jul	**51.9 (52.8)**	52.0 (52.0)	50.2 (49.7)	-
UK	New car registrations Y/Y%	Jul	**11.3**	-	-34.9	-
	Final services (composite) PMI	Jul	**56.5 (57.0)**	56.6 (57.1)	47.1 (47.7)	-

Auctions

Country	Auction
Germany	sold €4.0bn of 0% 2025 bonds at an average yield of -0.72%
UK	sold £2.75bn of 0.375% 2030 bonds at an average yield of 0.138%
	sold £500mn of 0.125% 2048 index-linked bonds at an average yield of -2.291%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's data releases

Economic data

Country	BST	Release	Period	Market consensus/ Daiwa forecast	Previous
EMU	09.00	Construction PMI	Jul	-	46.3
Germany	07.00	Factory orders M/M% (Y/Y%)	Jun	10.1 (-18.5)	10.4 (-29.3)
	08.30	Construction PMI	Jul	-	41.3
Italy	09.00	Industrial production M/M% (Y/Y%)	Jun	5.0 (-16.0)	42.1 (-20.3)
UK	07.00	BoE Bank Rate %	Aug	0.10	0.10
	07.00	BoE gilt and corporate purchase bond target £bn	Aug	745	745
	09.30	Construction PMI	Jul	57.0	55.3

Auctions and events

Country	BST	Auction / Event
France	09.50	Auction: 5.5 % 2029 bonds
	09.50	Auction: 2.5% 2030 bonds
	09.50	Auction: 1.5% 2031 bonds
	09.50	Auction: 1.5% 2050 bonds
	09.50	Auction: Index-linked bonds
UK	00.01	REC/KPMG Report on UK Jobs for July
	07.00	BoE policy announcement and publication of its August Monetary Policy and Financial Stability Reports

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Daiwa Capital Markets

Yesterday's results

Economic data							
Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
EMU		PPI Y/Y%	Jun	**-3.7**	-3.8	-5.0	-
Spain		Unemployment change '000s	Jul	**-89.8**	20.0	5.1	-

Auctions		
Country		Auction
UK		sold £3.25bn of 0.125% 2026 bonds at an average yield of -0.068%
		sold £2.25bn of 1.25% 2041 bonds at an average yield of 0.592%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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